



Housing: Trends in Prices, Costs and Tenure

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**Chris Belfield
Daniel Chandler
Robert Joyce**

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**Series editors
Rowena Crawford
Carl Emmerson
Paul Johnson
Luke Sibieta**



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Chris Belfield, Daniel Chandler and Robert Joyce¹

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Executive summary

- House prices have risen in real terms over time but have also been subject to some strong swings. According to the Nationwide index, real average house prices trebled between 1995–96 and 2007–08. In part, this represented a recovery following a fall of 40% during the early 1990s. However, by 2007–08, real house prices were 77% higher than their previous peak in 1989. They then fell by almost a quarter between 2007–08 and 2012–13, before starting to grow again from 2013–14. In 2014Q4, they remained 17% below their 2007Q3 peak.
- In London, house prices grew faster than in the rest of the UK before the crisis and have since resumed growth more rapidly. Real house prices in London surpassed their previous peak during 2014.
- In 2013–14, average UK house prices were 6.9 times the level of average earnings – about the same as a decade earlier and still below the 2007–08 peak of 8.1. Young adults are the most likely to be considering buying their first home. The ratio of average house prices to the average earnings of 25- to 34-year-olds peaked at 7.7 in 2007–08 and was 7.2 in 2013–14.
- People’s regular outgoings on housing can move differently from house prices, depending on trends in mortgage interest rates and rents. During the recent crisis, many homeowners were helped by the dramatic fall in interest rates. On average, real housing costs for owner-occupiers with a mortgage fell by 38% between 2007–08 and 2012–13, taking the proportion of their income spent on housing costs from 16% to 10%. Of course, renters have not experienced the same scale of relief, and the proportion of their income spent on housing costs rose from 25% to 27% over the same period. As homeowners tend to be further up the income distribution than renters, this has had predictable distributional consequences, with those towards the top of the distribution seeing the most favourable trends in housing costs.
- Increases in house prices relative to incomes have probably been at least partly responsible for a significant decline in homeownership (and a rise in private renting) since the early 2000s, reversing the trend seen over the late 20th century. This largely reflects differences between generations: the age-25 homeownership rate fell from 45% for the mid-1960s birth cohort to 20% for the mid-1980s cohort. By age 35, the homeownership rate of those born in the mid-1970s remained 10 percentage points lower than for those born in the mid-1960s at the same age.

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- There have also been changes in the characteristics of people's housing, which may have direct implications for their living standards. For most working-age household types in England, floor space per person has been flat or has fallen since the mid-1990s; households with someone aged 60 or over, though, have seen increases in floor space per person. Trends have been less favourable in London (where space per person was already lower) and in the private rented sector. For private renters in London, space per person declined by a quarter between 1996 and 2012.
- The long-term decline in people per household came to a halt during the 2000s. This halt could partly be demand-driven: 'desired' household size may have stopped falling so rapidly because, for example, the rise in lone parents and one-child families slowed. However, there is also reason to think that it may partly result from supply constraints. The prevalence of multiple family units sharing the same household has been rising quickly, increasing in number by more than a third over approximately the past decade.

1. Introduction

Housing is a prominent public policy issue. Among the key reasons for this are big rises in house prices, concerns about mismatch between housing supply and demand, and falls in rates of homeownership. Worries about the 'affordability' of housing have probably been magnified by the more general squeeze on living standards since the recent recession and by wider debates around intergenerational issues such as the distribution of wealth across generations.

Housing is both an important and unusual good. It can have a large direct impact on people's welfare; it is something on which people spend a substantial proportion of their lifetime income; and for many homeowners, it is a very large component of their net wealth. Hence the impacts of housing on living standards, and the potential for housing trends to contribute to important inequalities across the population, are very large.

From an economic point of view, housing has many distinctive features. It is unusual in being both a consumption good and an investment good, and for owner-occupiers it is both simultaneously: it provides a flow of housing services, which affects living standards directly and immediately, but it is also an asset that can change in value and be sold on. Related to this is an important distinction, when thinking about the cost of housing, between house prices (the price of coming to own housing as an asset) and regular housing costs (outgoings on the consumption of housing, whether for renters or owner-occupiers). In the long run, there is likely to be a strong relationship between house prices, rents and mortgage interest costs, but they can move very differently over shorter periods.

Furthermore, housing is an asset on which a sizeable group of people have made large returns over quite a long period, due to the rapid real house price growth of the past 20 years. By the same token, it is now much more expensive to acquire for the first time than it used to be. This has potentially radically different implications for different generations.

Housing is sufficiently expensive that a large loan is typically required to purchase it for the first time. Hence, far more than for other goods that households buy, access to homeownership depends crucially on the functioning of the credit market, as well as on prices relative to income or liquid wealth. The magnitude of housing as a source of households' wealth – and the magnitude of mortgages as a source of debt – makes it of large potential importance for the wider economy.

Finally, housing supply can be inflexible: it takes time to build properties and the process may be inhibited by factors such as planning regulations. It has been argued that, even over long periods, housing supply has been quite unresponsive to price signals.²

The associated policy issues are wide ranging. Volatility in the housing market might undermine macroeconomic stability: the Governor of the Bank of England has highlighted it as the biggest risk to the UK's economic recovery,³ and the Bank's Financial Policy Committee is to be given new powers to guard against potential house price bubbles.⁴ Housing trends can have more direct implications for the public finances – in particular, via spending on housing benefit and subsidies for those in social housing, which support low-income renters.⁵ The appropriate tax treatment of housing, covered in detail in the Mirrlees Review,⁶ is both important and complex. The complexities flow in large part from housing's unusual characteristics, such as it being a bundle of both land and property and its special status as both an investment and consumption good.

A proper treatment of all such housing-related issues is beyond the scope of this briefing note. Instead, the focus here is on the most direct and immediate links between housing and the living standards of households, in terms of the costs that people face and the types of housing that they access. This includes an emphasis on distributional issues, such as inequalities between income groups, tenures and generations. A subsequent IFS election briefing note will look in detail at living standards more broadly.

We proceed as follows. Section 2 looks at changes in the cost of housing for different groups, distinguishing between the purchase price of houses, regular spending on housing costs, and concepts of 'affordability' with respect to both house purchases and regular housing costs. Section 3 looks at changes in housing circumstances, with a focus on tenure and dwelling size, and considers how these might be related to trends in prices and the balance of demand and supply. Section 4 reflects on the policy challenges that these trends present.

2. The cost of housing

Issues of cost or 'affordability' are at the heart of current debates about housing, but there are really several distinct concepts underlying this. This is particularly important at the moment because different measures have been moving very differently. To avoid confusion, it is important to be clear about the distinctions from the outset.

House prices are the up-front cost of coming to own a property (which will often be met with the aid of a mortgage loan, particularly for first-time buyers). They represent the price of buying an

² K. Barker, *Review of Housing Supply: Securing Our Future Housing Needs*, Interim Report, HM Treasury, 2003, http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/consultations_and_legislation/barker/consult_barker_background.cfm.

³ BBC, 'Bank of England's Mark Carney warns on housing market', 18 May 2014, <http://www.bbc.co.uk/news/business-27459663> (accessed 16 February 2015).

⁴ The Financial Policy Committee is to be given new powers of direction over the housing market – for example, through setting limits on debt-to-income ratios and loan-to-value ratios for mortgages (see HM Treasury, 'Government confirms new powers for Bank of England to guard against future financial risks', 2 February 2015, <https://www.gov.uk/government/news/government-confirms-new-powers-for-bank-of-england-to-guard-against-future-financial-risks>).

⁵ See chapter 9 of Office for Budget Responsibility, *Welfare Trends Report: October 2014*, 2014, http://budgetresponsibility.org.uk/wordpress/docs/Welfare_trends_report_2014_dn2B.pdf.

⁶ Chapter 16 of J. Mirrlees, S. Adam, T. Besley, R. Blundell, S. Bond, R. Chote, M. Gammie, P. Johnson, G. Myles and J. Poterba, *Tax by Design*, Oxford University Press for the Institute for Fiscal Studies, Oxford, 2011, <http://www.ifs.org.uk/publications/5353>.

asset (housing). The asset derives economic value from the fact that it provides a future flow of housing services.⁷ Having purchased the asset, the owner can decide whether to sell the housing services to someone else over a given period (i.e. to let out the property to a renter) or to 'consume' the housing services themselves (i.e. to be an owner-occupier).

Regardless of whether one owns a house, there are costs of consuming housing over a given period. For renters, the main monetary cost is their rent; for owner-occupiers with a mortgage, the main monetary cost is the interest that they are paying on their mortgage debt. (Owner-occupiers will also be repaying mortgage capital, but this is paying down their debt and hence increasing their net wealth. This is discussed further in Section 2.2.) For owner-occupiers, there are also other 'economic costs' incurred over a given period: the depreciation of their asset, or the expense of maintaining it so that it does not depreciate, net of any capital gain (known as the 'user cost'). The size of this economic cost matters because it affects the relative attractiveness of owner-occupation.

The regular costs of 'consuming' housing are related to the price of purchasing a house in various ways. Mortgage interest payments depend on the size of the mortgage, which will tend to vary with the price of the house. Purchasing a house with a mortgage is more attractive if (expected) interest payments are lower (other things being equal), so this might raise demand for housing as an asset and hence push up house prices. If rents are higher, housing is more attractive as an investment and this may also push up house prices. However, regular housing costs and house prices can move very differently. For example, house price changes have no direct impact on the mortgage interest of existing homeowners; and an interest rate change that is expected to be temporary will feed through directly into the current costs of housing consumption for many owner-occupiers, but with relatively little likely impact on house prices. In summary, both concepts are very relevant when thinking about the 'cost of housing' but they need to be carefully distinguished.

Any discussion of issues around 'affordability' needs to account for more than just costs or prices. For regular housing costs, it will matter how high they are relative to households' incomes (and perhaps liquid wealth); for access to housing as an asset, credit conditions will also matter greatly given that most buyers require a mortgage.⁸

In this section, we look first at changes in house prices before turning to look at changes in the amounts that people in different housing tenures spend on housing costs on a regular basis.

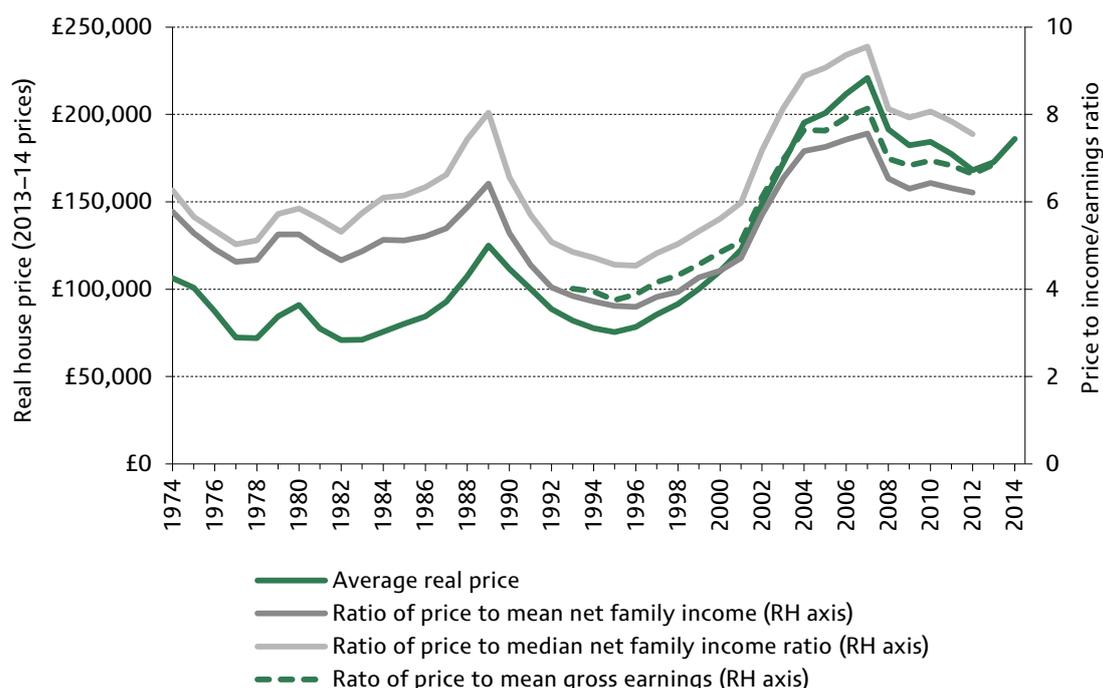
2.1 House prices

Most commentary focuses on nominal house prices. However, a more relevant measure is the 'real' price, which strips out the effects of general inflation. The solid green line in Figure 2.1 shows the price of an 'average' house adjusted for inflation measured using the consumer price index (CPI) and expressed in 2013–14 prices, using the Nationwide house price index. This index is 'quality adjusted' in the sense that it attempts to measure the price of a house of a fixed type over time. In doing so, it aims to isolate changes in the raw price of housing from changes in the types of houses being sold from one period to the next.

⁷ During a housing 'bubble', house price changes might be driven by pure speculation on their future price (independent of considerations of the value of the future flow of housing services), causing house prices to deviate from what is sometimes called their 'fundamental' economic value.

⁸ Cash purchasers (i.e. those buying without a mortgage) represented around one-third of property transactions in 2013. This represents an increase compared with the pre-recession period, when cash purchasers were closer to one in five of all transactions. The increase largely reflects the decline in mortgage-funded activity during and after the recession. See chart two of Council of Mortgage Lenders, 'A million property transactions: what does it mean for the mortgage market?', 21 November 2013, <http://www.cml.org.uk/cml/publications/newsandviews/150/585>.

Figure 2.1. UK house prices, price to income ratios and price to earnings ratios



Note: Years refer to calendar years up to 1992 and financial years from 1993 (where '1993' refers to the financial year 1993-94), except 2014 for which data are only available up to 2014Q4. House prices are calculated by averaging over the relevant quarters of the Nationwide house price index. Nominal house prices are deflated using the CPI excluding rents from 1996-97 onwards. Before 1996-97, this inflation measure is not available, so we use Rossi inflation minus 0.36 percentage points, which was the average difference between Rossi and the CPI minus rents between 1996-97 and 2008-09. The income measure used is net family income (the combined income of an adult and, if applicable, the partner they live with) for the adult population. Earnings are gross individual earnings of workers.

Source: Nationwide house price index; earnings from Labour Force Survey; income measured using the Family Expenditure Survey and the Family Resources Survey; price index – authors' calculations using ONS series D7G7, D7GQ, CIVC and GUMG.

Different house price indices do yield somewhat different estimates of growth in house prices, particularly over short periods. No index is clearly better than the others. We use the Nationwide index primarily because it provides a consistent series for the UK over the longest period of time. Figure A.1 in the appendix compares average real house prices according to the four major indices; while the long-run trends are broadly similar, some significant gaps have opened up between different indices since the recession. It is also important to note that the Nationwide index only provides an estimate of changes in the price of an 'average' house – which, in principle, can be influenced by growth in prices right at the top end of the distribution – so our discussion focuses on that. However, other data sources allow us to compare mean and median house prices. Figure A.2 in the appendix shows that changes in mean and median house prices have in fact been very similar since 1996, although the mean has grown more quickly than the median since the financial crisis (particularly in London).⁹

⁹ The Nationwide house price index uses housing transaction data to estimate the price of a house with characteristics that are 'typical' of houses sold over a (rolling) four-year period. The index is 'mix adjusted' – a standard method for isolating changes in price from changes in the quality of houses being sold from one period to the next (although persistent changes in quality will be incorporated into revisions to the definition of a 'typical' house, joining factors are used to maintain a consistent series). For a more detailed discussion of the methods and data underlying the different house price indices, and their advantages and disadvantages, see D. Chandler and R. Disney, 'Measuring house prices: a comparison of different indices', IFS Briefing Note BN146, 2014, <http://www.ifs.org.uk/bns/bn146.pdf>.

The Nationwide index suggests that the real mean house price nearly trebled from a trough of £76,000 in 1995–96 to a peak of £221,000 in 2007–08 (an increase of 193%). Part of this rise represented a recovery following a fall of 40% in the early 1990s. However, real house prices had exceeded their previous 1989 peak by 2002–03 and then continued to grow by more than 8% per year up until 2007–08. As a result, real house prices in 2007–08 were 77% higher than their previous peak (in 1989). They then fell by almost a quarter between 2007–08 and 2012–13, before starting to increase again in 2013–14. In 2014Q4, real house prices according to the Nationwide index remain 17% below their 2007Q3 peak – still more than double their level at the trough in 1995–96, and around 50% above their 1989 peak. Box 2.1 discusses some of the factors that help explain these long-run trends in house prices.

Of course, ‘affordability’ depends on the resources available to people as well as on house prices. It is therefore useful to look at changes in the ratio of prices to incomes and earnings. Doing this shows that house price movements have generally been greater than earnings changes in recent history. The dashed green line in Figure 2.1 shows the ratio of the average house price to average pre-tax earnings (which are taken from the Labour Force Survey and are available since 1992–93). While real average house prices trebled during the pre-recession house price boom from the mid-1990s to 2007–08, growth in earnings meant that the price to earnings ratio ‘only’ just over doubled (from a low of 3.7 to a high of 8.1). The price to earnings ratio also fell during and after the recession, by about 18% between 2007–08 and 2012–13, taking it back below its 2003–04 level, before rising slightly in 2013–14.

Box 2.1. What determines house prices?

The price of housing should reflect the balance of demand and supply: all else equal, an increase in demand will raise the price of housing and an increase in supply will reduce it.

The demand for a given unit of housing at a given quality is influenced by a range of factors. The most important of these are probably real income levels (current and expected), demographic structure and the availability of mortgage credit. As incomes increase, people tend to spend more on housing.^a The impact of demographic change is slightly more complex. Housing demand depends on both the size and the composition of the population – for example, a population with smaller families may demand more housing space than the same-sized population living in fewer, larger families. Easier access to mortgage credit is also likely to increase housing demand, given that most non-homeowners must borrow in order to purchase a house. Finally, housing is an asset as well as something that is purchased for consumption. Hence, it may become more or less attractive relative to other assets (such as bonds or equities), depending on factors such as expected risks and returns.

In the short run, the overall supply of housing is relatively fixed. This means that short-term increases in demand typically feed through into rising prices. Over longer periods, the responsiveness of supply to changes in house prices will depend above all on the supply of land, which in turn depends on the planning system and on the competitiveness, capacity and incentives faced by the construction industry. In a 2003–04 review, Kate Barker suggested that, even over longer periods, UK housing supply was not responding to price signals and that in large part this reflected constraints embedded in the planning system.^b

^a For a discussion, see the 2008 special issue of *Oxford Review of Economic Policy* (24:1) on housing policy, especially J. Muellbauer and A. Murphy, ‘Housing markets and the economy: an assessment’.

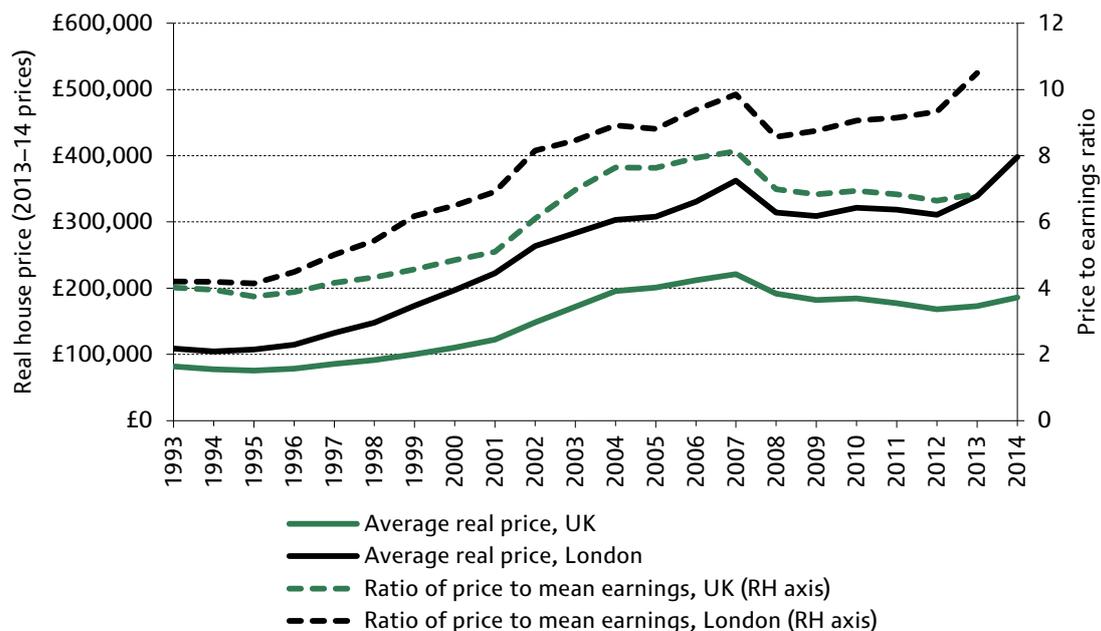
^b For a discussion, see K. Barker, *Review of Housing Supply: Securing Our Future Housing Needs*, Interim Report, HM Treasury, 2003, http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/consultations_and_legislation/barker/consult_barker_background.cfm.

Figure 2.1 also shows the ratios of average house prices to mean and to median net family income (the income measures are taken from the Family Expenditure Survey (FES) and Family Resources Survey (FRS)). Conceptually, these have advantages over the commonly-used house price to earnings ratio. By measuring resources at the family level, they can capture effects such as the trend towards more dual-earning couples; and by measuring net income, they capture the impact of the tax system and unearned income such as benefits. Another advantage of the FES/FRS data is that they allow for comparisons over a longer period of time. These reveal, for example, that the ratios of house prices to mean and median family incomes in the latest income data for 2012–13 were actually quite close to the previous peaks seen in 1989 (though these ratios are likely to have risen since).

However, using gross earnings data from the Labour Force Survey (LFS) – while conceptually inferior – has two important practical advantages. The LFS provides more recent data than the FRS, which is currently available only up until 2012–13; and it is a larger survey, enabling more robust subgroup analysis of these recent trends. Figure 2.1 shows that, recently, the story has been broadly the same whether looking at the ratio of prices to (mean or median) family income or the ratio of prices to individual earnings. In what follows, we therefore proceed with the standard house price to earnings ratio.

House prices in London are significantly higher than those in the rest of the country and have increased more rapidly in recent history. Figure 2.2 shows that real house prices increased more than threefold (by 247%) in London from their trough in 1994–95 to their peak in 2007–08. They have also recovered more strongly than in the rest of the UK since the financial crisis. The most recent data (2014Q4) suggest that average real house prices in London have now surpassed their previous peak in 2007–08. Earnings too are higher in London, but London still has a substantially higher house price to earnings ratio than the UK as a whole, and that gap between the London and UK price to earnings ratios has grown since the start of the house price boom in the early 1990s.

Figure 2.2. London and UK house prices and price to earnings ratios



Note: As for Figure 2.1.

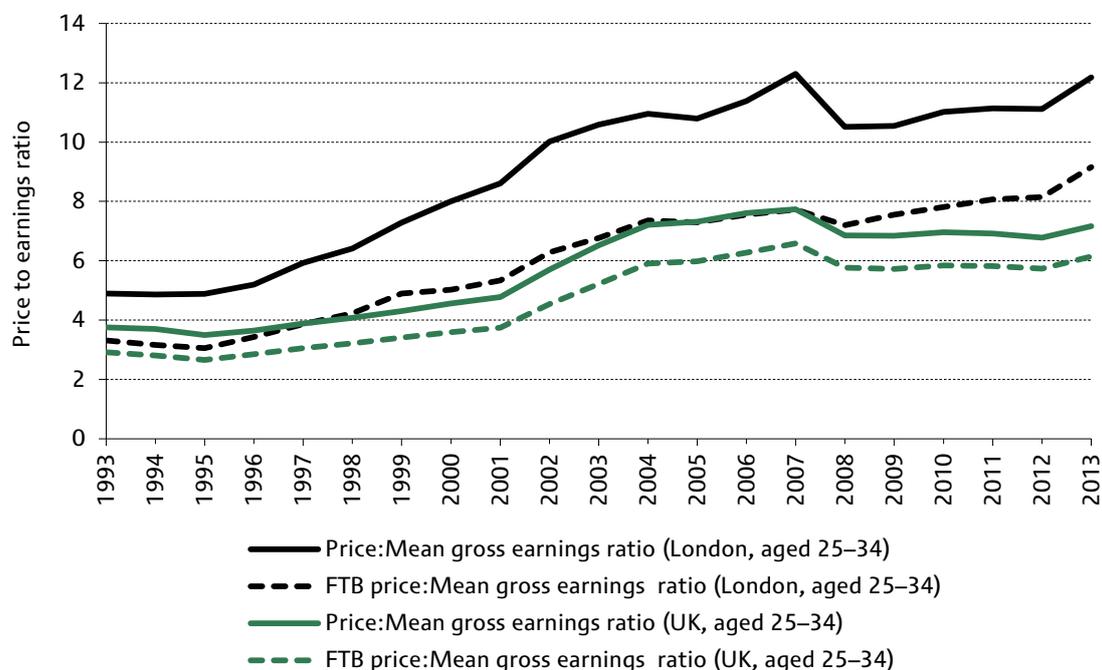
Source: As for Figure 2.1.

Using different data from the Land Registry, Figure A.2 in the appendix shows that median house prices in London have been growing somewhat less quickly than mean house prices in London since the financial crisis, suggesting that some of this resurgence is due to above-average increases in house prices towards the top end of the market. But taking a longer-run perspective and looking at the period since 1996 as a whole, mean and median house prices in London have increased by almost identical proportions. Figure A.3 further shows that the effect of looking at house prices relative to gross individual earnings, rather than net family income, is very similar in London and in the UK as a whole.

The relationship between house prices and the earnings of younger people might be of particular interest. Young adults are less likely to already own property and more likely to be considering purchasing their first home (the average age of a first-time buyer has been in the early 30s since 1990¹⁰). Figure 2.3 shows the price to earnings ratio for those aged 25–34. A comparison with Figure 2.2 shows that the house price to earnings ratio is a little higher when focusing on young adults' (lower) earnings: in 2013–14, the ratio of mean house prices to mean earnings of 25- to 34-year-olds is 7.2, compared with 6.9 when looking at the ratio of prices to mean earnings for all adults. Across the UK, the house price to earnings ratio has grown faster since 1993, and has recovered more since 2007–08, for those aged 25–34 than for the population as a whole, reflecting lower earnings growth among this younger age group. Interestingly, this is not true in London, however.

Of course, the average house bought by first-time buyers will be different from the average house bought by the population as a whole in a given year. Figure 2.3 also shows how the price of houses bought by first-time buyers has evolved relative to young people's earnings. As one would

Figure 2.3. House price to earnings ratios for 25- to 34-year-olds only, using all prices and prices paid by first-time buyers



Note: As for Figure 2.1. 'FTB price' refers to the average price paid by first-time buyers.

Source: As for Figure 2.1.

¹⁰ See table 37 of Office for National Statistics, 'House price index: reference tables – annual tables 20 to 39', 18 November 2014.

expect, properties bought by first-time buyers are considerably cheaper than the average, and as such the ratio of this price to young people’s earnings is considerably lower. However, the evolution of the two ratios (of average prices and prices paid by first-time buyers, to mean earnings for 25- to 34-year-olds) is broadly similar. In other words, the price of houses bought by first-time buyers has grown broadly in line with the average price. It is, of course, possible that the types of properties bought by first-time buyers have also been changing over time, but this should not cause trends in this measure of house prices to move differently for first-time buyers compared with others, because the price index is ‘quality adjusted’ (see above).

2.2 Spending on regular housing costs

Another important aspect of ‘housing affordability’ is the amount households are spending on their housing on a regular basis. These regular costs are clearly related to house prices. For example, monthly mortgage interest payments depend on the size of the mortgage, which will tend to vary with the price of the house. Higher (expected) rents increase the attractiveness of housing as an investment and this may push up house prices. However, these costs are conceptually different from house prices, and they can move differently. For example, in the short run, mortgage interest costs are rather insensitive, on average, to changes in house prices because those prices have no direct impact on the mortgage debt of existing homeowners; on the other hand, the costs of servicing a mortgage for a house of a given price are very sensitive to interest rate changes (the majority of outstanding mortgage balances are variable rate, though in recent years the majority of new lending has been on fixed-rate mortgages¹¹).

We should also think about affordability differently depending on whether we are considering house prices or regular housing costs. Few first-time buyers purchase a house outright, so the ‘affordability’ of a given house price depends crucially on the availability of credit. For most households, this will be much less relevant when it comes to meeting a given level of regular housing costs, for which the key issue is likely to be the levels of these costs relative to their income or liquid wealth.

For this analysis, we use the Family Resources Survey from 1994–95 and the Family Expenditure Survey in earlier years. These contain data on the actual housing costs paid by each household in the survey. The key housing costs are mortgage interest payments and rents, though they also include water charges, buildings insurance premiums for owner-occupiers, and ground rents and service charges. Table 2.1 sets out the proportion of the population in different housing tenures and the housing costs that are included for each of these groups. (In Section 3.2, we look in detail at how housing tenures have been changing over time.)

Table 2.1. Tenure types and housing costs

Housing tenure	% of population	Housing costs included
Owned outright	27%	Buildings insurance premiums, water rates/charges, ground rent, service charges
Owned with mortgage	38%	Mortgage interest plus the above
Private rented	17%	Rent, water rates/charges
Social rented	16%	Rent, water rates/charges

Note: Percentages do not sum to 100% as 1% of the population have a housing tenure categorised as ‘other’. Rents are gross of housing benefit (where stated, we also conduct analysis after netting off housing benefit).

Source: Authors’ calculations using the Family Resources Survey 2012–13.

¹¹ Table C in Bank of England, ‘Mortgage lenders and administrators statistics for 2014 Q3’, 2014, <http://www.bankofengland.co.uk/prs/Documents/regulatorydata/mlar/2014/Q3.pdf>.

Mortgage capital repayments are not included as costs here, on the basis that they represent the paying back of a debt and hence the accumulation of net wealth, rather than spending in the ordinary sense. This is in line with how other loan repayments (excluding the interest component) would normally be treated when measuring living standards or the cost of living (i.e. they would normally be ignored). Of course, households might still feel that a commitment to pay down their mortgage each month is squeezing their current living standards. Unlike mortgage interest or rental payments, though, these payments are increasing their wealth.

It is important to note that the survey data we use measure spending, not prices. They are simply survey records of actual housing costs paid, so there is no adjustment made for the quality or quantity of housing that these costs are associated with. This is different from the house price series discussed previously. This distinction is not likely to be very important when looking over short periods, but may well matter in the long run if the kind of housing that people are willing to pay for changes (perhaps in response to price changes). The Office for National Statistics (ONS) produces estimates of private sector rental prices, which do attempt to adjust for quality changes. These are discussed further below and in Box 2.2.

Figure 2.4a shows real average housing costs over time, for the whole population and broken down by housing tenure.¹² We equalise these housing costs to account for the fact that, while £1 spent on housing always leaves £1 less to spend on other (non-housing) things, £1 of non-housing spending would 'go further' for some households than others, depending on the size and composition of the household. Cash amounts in the figure are the equivalents for a childless couple.

Real spending on regular housing costs rose substantially during the house price boom between 1995–96 and 2007–08, by 70% for owner-occupiers with a mortgage and by 49% for renters. It is noteworthy, however, that these rises are significantly smaller than the rise in house prices of 193% (a near trebling) over the same period. The acceleration in the rate of increase of housing costs also came somewhat later than that in house prices, occurring only from the early 2000s. Combined with the fact that incomes were growing over this period too, this meant that the proportion of income spent on housing costs actually remained relatively stable during the late 1990s and early 2000s, as shown in Figure 2.4b.

To some extent, the delayed impact of house prices on housing costs might be expected, as house price rises will only directly and immediately affect the mortgage costs of those currently buying a house. There is also evidence that this period saw an increasing proportion of first-time buyers taking out mortgages with long terms (exceeding 25 years)¹³ – allowing households to mitigate the impact of rising overall housing and borrowing costs on their monthly payments. However, this analysis does not show how the quality of housing has been changing at the same time. It is also possible that the quality or quantity of housing consumed by households has been falling, such that households could now be spending a similar share of income on housing to what they were spending before, but getting lower-quality housing. In Section 3.1, we do provide evidence of significant reductions in floor space per person over time for some groups (e.g. renters in London), although the ONS suggests that in the private rented sector other measures of 'quality' (e.g. state of repair) have been improving (see Box 2.2 for more discussion). A full analysis of

¹² Here we include those who own their home with a mortgage or rent (private and social). Together, they account for 66% of households, 72% of individuals and virtually all housing costs. Most of the remaining third of households own their homes outright and therefore pay no rent or mortgage costs.

¹³ See chart 2.28 in Bank of England, *Financial Stability Report: November 2013*, <http://www.bankofengland.co.uk/publications/Pages/fsr/2013/fsr34.aspx> and S. P. Chan, 'Boom in 30-year mortgages as house prices spiral', *Telegraph*, 23 August 2014, <http://www.telegraph.co.uk/finance/economics/11052360/Boom-in-30-year-mortgages-as-house-prices-spiral.html>.

changes in housing quality is beyond the scope of this briefing note and is currently somewhat constrained by a lack of data, but it is an area worthy of further research.

Box 2.2. Private rental prices

The Office for National Statistics publishes an index of private housing rental prices (IPHRP).^a This index attempts to adjust for changes in the types of properties being privately rented over time – so, unlike actual rents paid measured in the Family Resources Survey, it is attempting to measure a ‘pure’ quality-adjusted price. This series was recently revised, after flaws were discovered in the previous measure which led it to seriously understate growth in private rental prices.

The new IPHRP measure still shows much less rent growth than the FRS (or the Survey of English Housing). It suggests that, between 2005–06 and 2012–13, private rental prices fell by 8% in real terms. The FRS suggests that actual rents paid by private renters grew by 2% in real terms between 2005–06 and 2012–13. Between 2007–08 and 2012–13, the IPHRP shows a real-terms fall of 8%, while the FRS shows a real-terms increase of 2%.

There is no index available for quality-adjusted social rents, but the FRS suggests that social rents have risen slightly relative to private rents in recent years. (Note that, for conciseness, the numbers in Figure 2.4 refer to all renters – social and private sector – rather than private and social renters separately.)

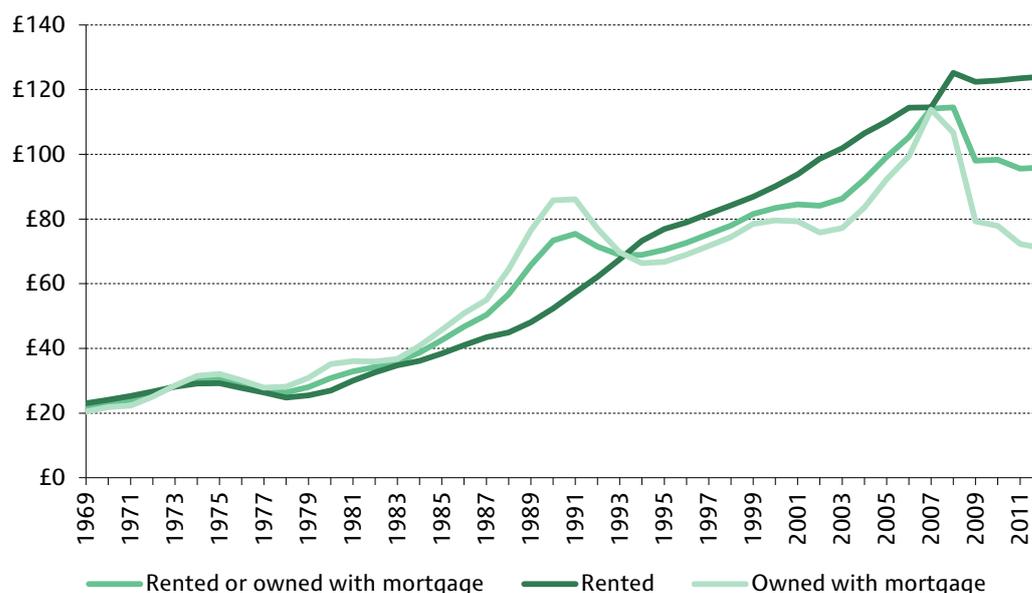
The ONS suggests two primary reasons for the differences between the IPHRP and the FRS. First, there have been compositional changes in the privately-renting population – in particular, more of them renting in London – which push up average rents paid (as picked up by the FRS) but do not directly affect the pure price of rental accommodation (as the IPHRP tries to measure). Second, there have been other quality-improving changes to the characteristics of privately-rented properties (e.g. newer properties in a better state of repair and/or in more affluent localities), which mean that raw rents paid have grown faster than the pure rental price of a given type of property.

Our own analysis suggests that the compositional shift in the privately-renting population towards London does not explain much of the difference between the two measures in recent years. Real average private sector rents according to the FRS have been approximately flat since the mid-2000s – or have risen slightly – in London, outside of London and in the UK as a whole. Other changes to the characteristics of privately-rented properties may, however, explain some of the difference.

Notwithstanding these issues, we can draw at least two conclusions. First, rents have not generally been increasing particularly quickly relative to the prices of other goods, perhaps contrary to popular perception. Second, however, there is clearly a big difference here between the experiences of renters and homeowners. The latter group have, if they have a mortgage, seen a historically large fall in their regular housing costs. The scale of relief for renters has been nowhere near as large. In combination with falls in real incomes and the high cost of entering homeownership (i.e. high house prices), this means that the living standards of renters have been squeezed considerably and that the relative advantage of those who already own a home over those still in the rented sector has probably increased.

^a Discussion of the IPHRP series in this box draws on R. Lewis and A. Restieaux, ‘Improvements to the measurement of owner occupiers’ housing costs and private housing rental prices’, Office for National Statistics, 2015.

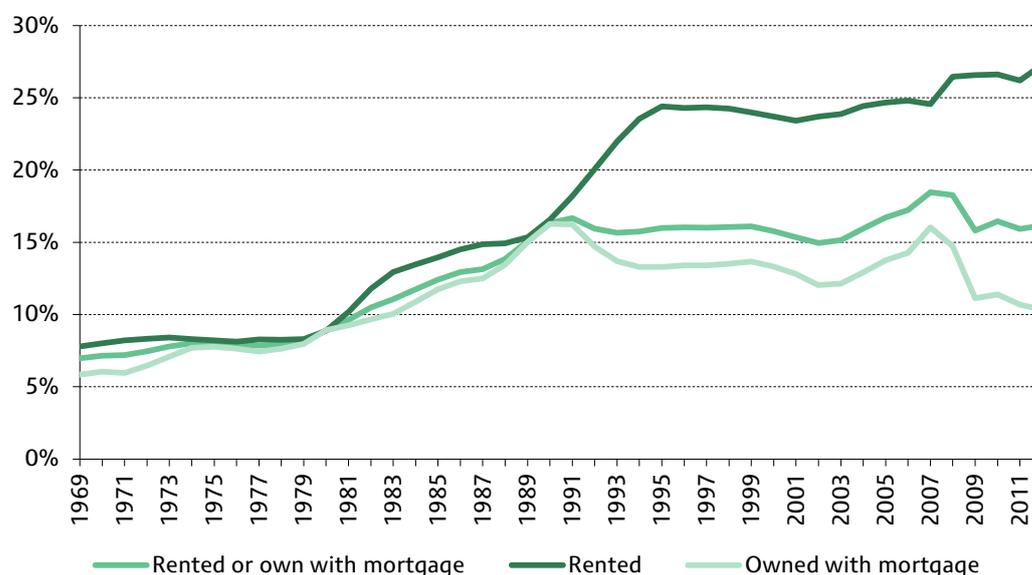
Figure 2.4a. Real equivalised mean weekly housing costs by tenure type (GB)



Note: Housing costs are equivalised and gross of housing benefit. They include mortgage interest payments, rents, water charges, buildings insurance premiums for owner-occupiers, and ground rents and service charges. Years represent financial years after 1992. Up until 2005–06, figures are three-year moving averages due to the small number of private renters in past years.

Source: Authors' calculations using the Family Resources Survey and Family Expenditure Survey, various years, and ONS series D7G7, D7GQ, CJVC and GUMG.

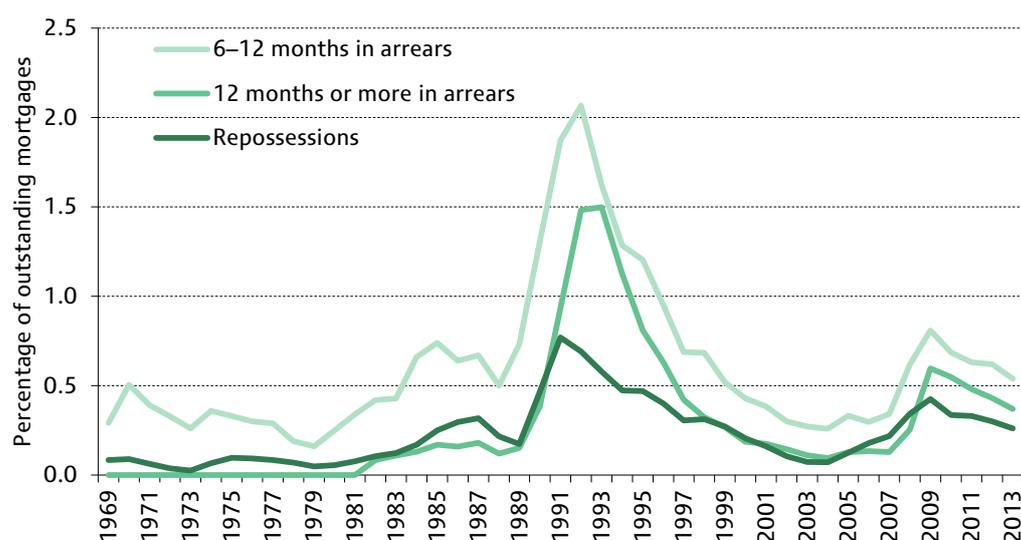
Figure 2.4b. Percentage of income spent on housing costs by tenure type (GB)



Note: Income is measured before housing costs are deducted. Housing costs are gross of housing benefit. They include mortgage interest payments, rents, water charges, buildings insurance premiums for owner-occupiers, and ground rents and service charges. Years represent financial years after 1992. Up until 2005–06, figures are three-year moving averages due to the small number of private renters in past years.

Source: Authors' calculations using the Family Resources Survey and Family Expenditure Survey, various years, and ONS series D7G7, D7GQ, CJVC and GUMG.

Figure 2.5. Repossessions and arrears since 1969 in the UK



Note: Arrears are measured at the end of each calendar year, while repossessions are measured over each calendar year. Source: ONS, table 1300, 'Repossession and repossession prevention'.

Since the start of the financial crisis, average housing costs have fallen, driven by reductions in costs for those with a mortgage. For these people, real spending on housing costs fell by 38% and from 16.0% to 10.3% as a proportion of their income. As a share of income, this is lower than at any point since at least 1984. This is of course not surprising: the average standard variable interest rate on a mortgage halved in 18 months, falling from 7.7% in October 2007 to 3.8% in April 2009.¹⁴ It is probably a key explanation for the much lower rate of repossessions and mortgage arrears than after the early 1990s recession and house price crash (when interest rates rose to double digits), which is shown in Figure 2.5. In other words, while it seems to have been getting harder to purchase one's first home (due to house price trends), it has been getting easier to hold onto it (due to trends in regular housing costs for mortgagors).

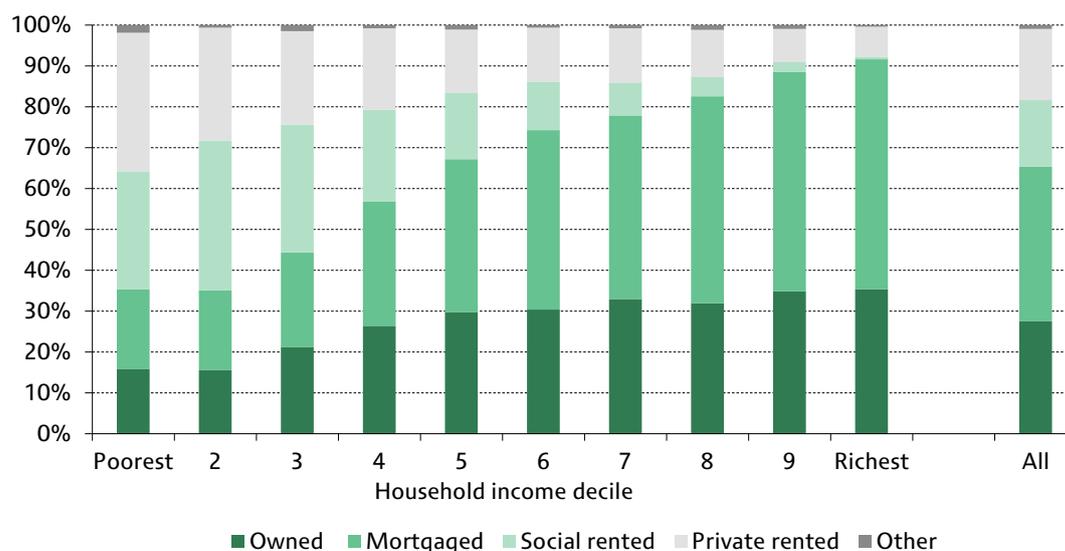
In contrast to the falling housing costs of mortgagors, the average housing costs paid by renters have been roughly flat, and if anything have risen slightly, in real terms between 2007–08 and 2012–13; these costs have risen from 24.6% to 27.3% as a proportion of renters' income. Within this average, social rents have risen slightly relative to private rents (which are discussed in more detail in Box 2.2). In summary, housing costs have clearly not been offering the same scale of relief at a time of falling incomes to renters as they have to homeowners. This has had important distributional consequences.

First, it has translated into differences in housing costs trends across the income distribution. This is mainly because, as Figure 2.6 shows, those towards the bottom of the income distribution are less likely to be owner-occupiers.¹⁵ Figure 2.7 shows that housing costs therefore fell by over

¹⁴ Source: Bank of England series IUMTLMV (available at <http://tinyurl.com/k2wwdpm>, accessed on 16 December 2014).

¹⁵ Note also that housing costs here are measured gross of housing benefit. Many renters on low incomes are not affected, or are less affected, by changes in rents because their housing benefit entitlements change when rents change. The FRS data show 29% of households in the bottom half of the income distribution on housing benefit, and this is probably an underestimate because the survey picks up only 77% of actual housing benefit payments (appendix B of C. Belfield, J. Cribb, A. Hood and R. Joyce, *Living Standards, Poverty and Inequality in the UK: 2014*, IFS Report 96, 2014, <http://www.ifs.org.uk/publications/7274>). Having said that, there have been several recent cuts to housing benefit, which are discussed in more detail in A. Hood and D. Phillips, 'Benefit spending and reforms: the coalition government's record', IFS Briefing Note BN160, 2015, <http://election2015.ifs.org.uk/uploads/publications/bns/BN160.pdf>.

Figure 2.6. Housing tenure by income decile in the UK, 2012–13



Note: Income decile groups are derived by dividing all households into 10 equal-sized groups based on their equivalised income after housing costs.

Source: Authors' calculations using Family Resources Survey 2012–13.

Figure 2.7. Change in housing costs by income decile in the UK between 2007–08 and 2012–13



Note: Income decile groups are derived by dividing all households into 10 equal-sized groups based on their equivalised income after housing costs (AHC). Housing costs include mortgage interest payments, rents, water charges, buildings insurance premiums for owner-occupiers, and ground rents and service charges.

Source: Authors' calculations using Family Resources Survey, 2007–08 and 2012–13, and ONS series D7G7, D7GQ, C1VC and GUMG.

Table 2.2. Change in housing costs by age group and tenure between 2005–06 to 2007–08 and 2010–11 to 2012–13

	Aged 25–34	Aged 35–59	Aged 60+	All aged 25+
Change in pounds (weekly)				
Owned with mortgage	–£43	–£26	–£4	–£29
Rented	£1	£13	£10	£9
<i>Of which:</i>				
Social rented	£6	£7	£8	£7
Private rented	–£10	£6	£13	–£1
All	–£16	–£9	£0	–£8
Change as a percentage of (2005–06 to 2007–08) AHC income				
Owned with mortgage	–7.3%	–4.2%	–0.8%	–4.9%
Rented	0.3%	3.9%	3.3%	2.7%
<i>Of which:</i>				
Social rented	2.1%	2.4%	2.6%	2.2%
Private rented	–2.3%	1.4%	4.0%	–0.2%
All	–3.1%	–1.5%	–0.1%	–1.6%
Percentage of age group in each tenure				
Owned with mortgage	41%	52%	9%	36%
Rented	50%	26%	20%	29%
<i>Of which:</i>				
Social rented	15%	14%	16%	15%
Private rented	35%	11%	4%	14%

Note: All figures except mean incomes are calculated for a subsample of households in the FRS, which excludes those with negative incomes. All incomes have been equivalised and are measured at the household level.

Source: Authors' calculations using the Family Resources Survey, various years, and ONS series D7G7, D7GQ, CJVC and GUMG.

20% in each of the top four income decile groups, but by less than 10% in each of the bottom four (and if anything rose slightly in the second and third decile groups) between 2007–08 and 2012–13. It also shows that this distributional pattern is very similar if one looks at housing costs net of housing benefit – which is a natural thing to do when looking by income decile, as housing benefit is means-tested. As the big changes in housing costs happened for those with mortgages, who cannot receive housing benefit, it is unsurprising that including it makes little difference.

Second, changes in housing costs have affected different age groups differently, as Table 2.2 shows. Within each age group, we also show figures for the subgroups who live in private rented accommodation, social housing and owner-occupied mortgaged housing (these groups account for almost all housing costs). To ensure sufficient sample sizes within each group, we compare pooled three-year sets of data (2005–06 to 2007–10 and 2010–11 to 2012–13) rather than single years, so these figures are not directly comparable to those discussed above.

Young adults have actually seen larger reductions in housing costs than other age groups since the start of the recession. This is despite the fact that, as we show in Section 3.2, more young adults are remaining in the rented sector and hence not benefiting from low mortgage interest rates. The explanation is threefold. First, young adults who do have a mortgage have higher mortgage debt than older mortgagors, on average, and so benefit more from falls in mortgage interest rates. Second, young renters are more likely than older renters to rent from a private

landlord, and private rents have fallen relative to social rents since 2007–08. Third, the rents paid by young private renters have fallen relative to the rents paid by older private renters. It is less clear why this is. It is possible that it is associated with falls in the quality of accommodation inhabited by younger renters. We provide some limited evidence of this, with respect to floor space, in Section 3.1.

Hence, young adults in particular highlight the importance of distinguishing between concepts of cost, as argued at the start of this section. The impacts of high house prices on the ease with which one can purchase housing as an asset are especially important for the young; on the other hand, the benefits of the current period of low interest rates for those who *have* managed to move into homeownership have been particularly large for younger homeowners, because they tend to have lots of outstanding mortgage debt. Overall then, there are reasons to think that recent housing trends have been adding to inequalities *within* younger age groups, as well as to potential inequalities across generations.

In summary, the ‘affordability’ of housing is not simply about the purchase price of a house, and the large fall in mortgage interest rates has been one major factor cushioning the living standards of many households since the recession. To some extent, that relief is likely to be temporary. The path of future interest rates is uncertain, but the level to which interest rates plummeted in the wake of the financial crisis seems unlikely to be a new long-run equilibrium. More definitively, it has obviously not helped the 62% of the population without a mortgage. These patterns have had important distributional implications, with higher-income households – who are more likely to own houses – being the primary beneficiaries of the falls in mortgage rates. It is also possible that, by raising the attractiveness of owning, lower interest rates have kept house prices higher than they would otherwise have been. That in itself creates problems for those wanting to move into homeownership, with another set of potential distributional implications – for example, between generations. Trends in homeownership are one of the key themes of the next section.

3. How have people’s housing circumstances been changing?

We saw in Section 2 that house prices have increased significantly over the past 15 years, though regular housing costs have increased less. In this section, we explore changes in the kinds of housing that people are in, and consider how these may be related to the changes in prices and costs.

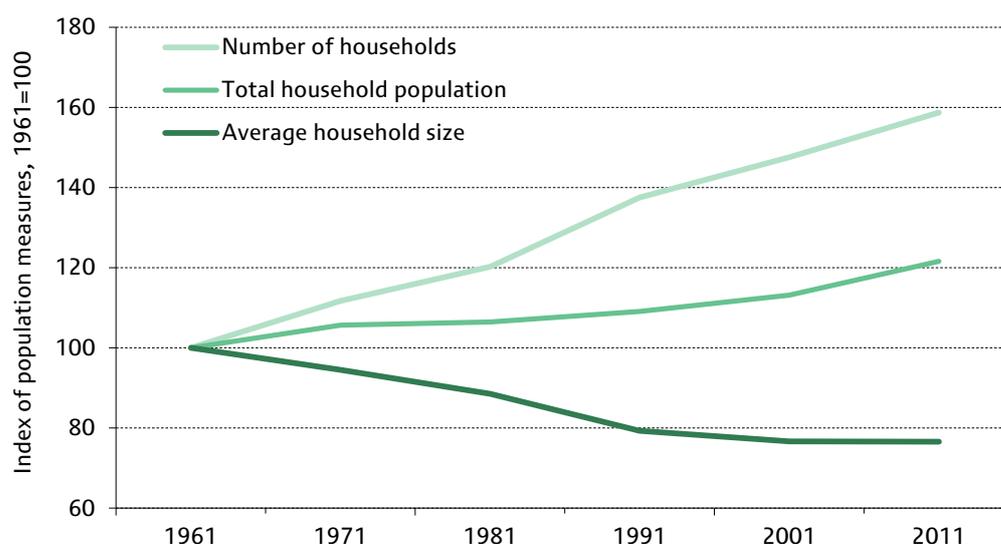
3.1 Housing supply and population

Figure 3.1 shows that the number of households in Great Britain has been on an upwards trend throughout the past few decades, and increased by 42% overall between 1971 and 2011. The number of separate dwellings has increased by a similar amount.¹⁶ This is actually substantially faster growth than seen for the household population over the same period, which grew by 15% from around 52 million individuals in 1971 to 60 million in 2011.¹⁷ This reflects a long-term decline in average household size, and therefore in the number of people per dwelling. It is

¹⁶ There is a close, but not identical, relationship between the number of households and the number of dwellings. There are two reasons why the number of households and the number of dwellings may differ: (1) although most dwellings contain one household, it is possible for a dwelling to contain multiple households and (2) some dwellings are vacant. In practice, the difference between the number of dwellings and the number of households has changed little over time.

¹⁷ The household population includes people whose place of usual residence is a household, and not within managed residential accommodation in a communal establishment.

Figure 3.1. Population trends since 1961, Great Britain (1961 = 100)



Note: The household population includes people whose place of usual residence is a household, not within managed residential accommodation in a communal establishment.

Source: ONS, '2011 Census: population and household estimates for England and Wales', 2012; National Records of Scotland, 'Table A19: usual residents of households, households by number of usual residents in household, average household size, Scotland, 1961 to 2011', 2013.

noteworthy, though, that this decline in household size slowed considerably during the 1990s and essentially came to a halt during the 2000s.

The fact that we now have fewer people per household than in the past does not imply that housing supply has risen relative to demand. This is because 'desired' household size has probably been falling, due to demographic changes such as more single-adult households and fewer children per family.¹⁸ These have exerted downwards pressure on desired household size, and correspondingly upwards pressure on the demand for houses relative to the number of people.

Figure 3.1 shows that the decline in household size has slowed since the early 1990s, and essentially stopped during the 2000s. Analysis of the 2011 Census suggests that the increase in the overall number of households in England between 2001 and 2011 was 375,000 less than would have been expected given the previous trend in household size and the growth in the population.¹⁹ In principle, this could be either because the rate of decline in desired household size has slowed or because constraints, in terms of the cost or availability of housing, have become more severe. There are reasons to think that both of those factors may have been playing a role.

Defining a family narrowly as consisting of an adult plus any partner and dependent children they live with (ignoring any other household members), average family size has been on a long-run downwards trend. All else equal, we would expect this to result in a fall in 'desired' household size. However, this decrease started to slow during the 1990s. Average family size fell

¹⁸ See ONS, 'Households and families' in *Social Trends*, 2010, 40, <http://www.ons.gov.uk/ons/rel/social-trends-rd/social-trends/social-trends-40/index.html>.

¹⁹ This estimate essentially compares 2011 Census household estimates with the Department for Communities and Local Government (DCLG)'s 2008-based population projections, after adjusting for the fact that population growth was also faster than expected. See table 6 of DCLG, 'Household interim projections, 2011 to 2021, England'. 2013, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/190229/Stats_Release_2011FINALDR_AFTv3.pdf.

by just 0.7% in the 2000s, having fallen by 2.7% in the 1970s and 7.9% in the 1980s.²⁰ Key factors behind this change in trend include a slowing of the rise in lone-parent families and one-child families.²¹ Therefore, the slowing of the fall in household size probably partly reflects a slowing of the decline in *desired* household size.

However, as argued by Holmans (2014),²² there are reasons to believe that the cost or availability of housing may have also been a factor slowing down the fall in average household size. Multi-family households have been the fastest-growing household type, increasing in number by more than one-third over approximately the past decade.²³ The number of 'concealed families' (lone parents or couples, plus any of their dependent children, who live as part of someone else's household) increased in the decade to 2011, reversing a 50-year downward trend. This increase was largest in London (where, as the previous section showed, the cost and 'affordability' of housing have increased most).²⁴ Another specific example of the rise in multi-family households is the rise in the prevalence of young adults living with their parents. Between 1996 and 2013, the number of adults aged 20–34 living with their parents increased by 25%.²⁵ In summary, there is some reason to suspect that housing demand pressures would have led to a larger increase in the number of households (and a larger decrease in household size) in recent history were it not for supply-side constraints.

Floor space

Another way of looking at the stock of housing is to look at total space (per person), rather than just the number of separate households or dwellings. We can do this, since 1996 and for England only, using the English Housing Survey (EHS) and predecessors.

Overall, floor space in England has increased slightly more quickly than the population, so floor space per person has increased from 35.0 square metres in 1996 to 36.4 square metres in 2012 – an increase of 3.9%.²⁶ Again though, the impact of demographic change needs to be understood. Larger households will tend to demand less space per person than smaller households (e.g. two single people living alone would each have a kitchen, whereas a couple would typically have one kitchen between them). As such, declining household size – which is most likely demand-driven, due to demographic change, as discussed above – is likely to increase the total demand for living space. Therefore rises in space per person should not be taken as an indication that supply has risen relative to demand.

²⁰ Source: Authors' calculations using the Family Expenditure Survey for the 1970s and 1980s and the Family Resources Survey for the 2000s.

²¹ ONS, 'An overview of 40 years of data (General Lifestyle Survey Overview - a report on the 2011 General Lifestyle Survey', 2013, http://www.ons.gov.uk/ons/dcp171776_302655.pdf.

²² A.E. Holmans, 'Housing need and effective demand in England', Cambridge Centre for Housing and Planning Research, 2014, <http://www.cchpr.landecon.cam.ac.uk/Projects/Start-Year/2014/Other-Publications/Housing-need-and-effective-demand-in-England/Report>.

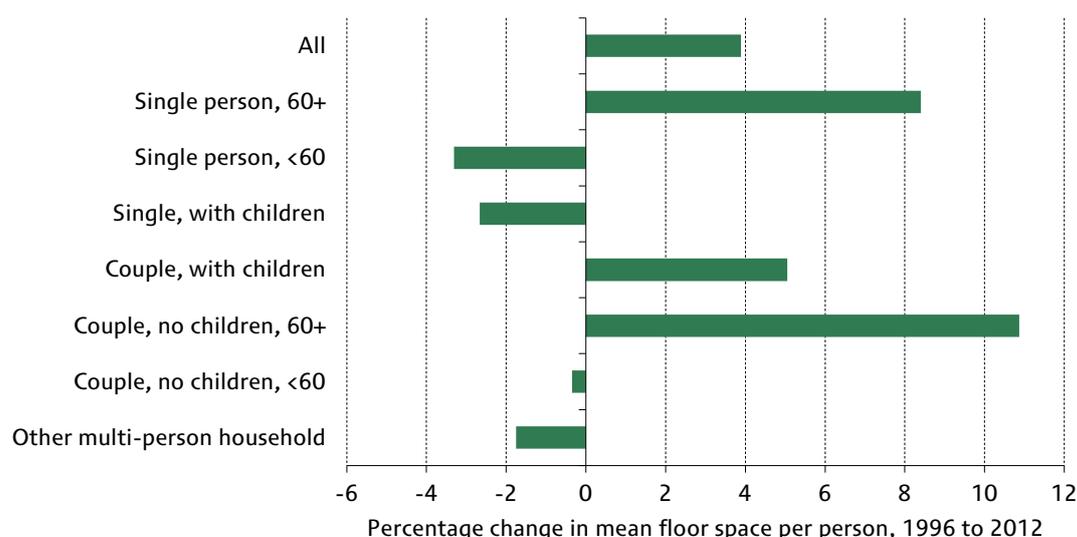
²³ They increased in number by 39% between 2003 and 2013. See ONS, 'Families and households, 2013', 2013, <http://www.ons.gov.uk/ons/rel/family-demography/families-and-households/2013/index.html>.

²⁴ See ONS, 'What does the 2011 Census tell us about concealed families living in multi-family households in England and Wales?', 2014, http://www.ons.gov.uk/ons/dcp171776_350282.pdf.

²⁵ ONS, 'Young adults living with parents, 2013', 2014, <http://www.ons.gov.uk/ons/rel/family-demography/young-adults-living-with-parents/2013/index.html>. Other factors may have contributed to this trend, such as the decline in young adults' incomes relative to those of older adults.

²⁶ The English House Condition Survey (EHCS) from 2003 and the EHS Housing Stock Dataset are provided on two-year rolling bases, with appropriate two-year weights that are calibrated to control totals at the centre of the survey period. For example, the EHS for '2012' covers properties surveyed between April 2011 and March 2013, with weights calibrated to 1 April 2012.

Figure 3.2. Change in floor space per person by household type, 1996 to 2012



Note: Excludes vacant properties. The measure of floor space provided in the EHS data was changed in 2006. For consistency, the 2012 figures have been derived using the pre-2006 methodology. The weights in 1996 have also been adjusted to account for a change in weighting methodology between 2007 and 2008, which affected the prevalence of different household and tenure types. EHCS and EHS data since 2003 are based on a two-year rolling sample, so '2012' refers to the period between April 2011 and March 2013.

Source: Authors' calculations using the English House Condition Survey and the English Housing Survey.

Mean floor space per person varies significantly by household type, ranging from 74 square metres per person for single people aged 60 and over, to 25 square metres for couples with dependent children. As such, changes in the relative prevalence of different household types can have a large effect on average space per person overall. Figure 3.2 looks at changes in floor space for specific household types. This effectively strips out changes in floor space that are driven purely by demographic shifts that change the prevalence of different types of household. The graph shows that floor space per person has fallen for single adults under 60 (with and without children) and for households containing more than one family unit (as narrowly defined above). However, it has clearly risen for households with someone aged over 60 (both singles and couples), and to a lesser extent for couples with children. Couples aged 60 and over without children have seen an 11% increase in space per person, while single people over 60 have seen an increase of 8%.

Given that incomes were increasing for most groups over much of this period (at least up to 2007–08), we might have expected to see increases in space per person within household types, due to demand for housing rising with income. Again, one plausible explanation for why we haven't seen this is that supply has not expanded to meet such additional demand (although there may have been an improvement in housing quality along dimensions other than floor space).

There have also been strikingly different trends in floor space per person by region and by housing tenure, as Table 3.1 shows. Outside of London, floor space per person in England rose by 4.5% between 1996 and 2012, whereas in London (where it was, on average, already smaller) it fell by almost the same proportion (4.4%). Living space per person among owner-occupiers has been increasing, and living space per person in the private rented sector has been falling substantially – by 25% for private renters in London and by 16% for private renters in the rest of England between 1996 and 2012. Interestingly, private renters in London now occupy less space per person than those living in social housing – a reversal of the situation in 1996 and 2004.

Table 3.1. Mean floor space per person (square metres) in different tenures: London and the rest of England

	<i>London</i>				<i>England (excluding London)</i>			
	Own	Private rent	Social rent	All	Own	Private rent	Social rent	All
1996	34.3	31.0	26.4	31.7	37.5	36.0	29.6	35.9
2004	36.4	27.8	25.9	32.2	38.6	31.8	29.0	36.3
2012	37.1	23.1	25.2	30.3	41.1	30.4	28.1	37.5

Note: As for Figure 3.2.

Source: As for Figure 3.2.

We might be interested in the overall distribution of housing space, as well as how space compares between different population groups. The EHCS/EHS data suggest that overall inequality in space per person has changed little recently: for example, the ratio between the 90th and 10th percentiles of the distribution has been broadly constant since 1996. On the other hand, recent work by Tunstall (2015)²⁷ did suggest that inequality in *rooms* per person has been increasing. This difference may indicate changes in room sizes, and would be an interesting topic for future research.

3.2 Housing tenure

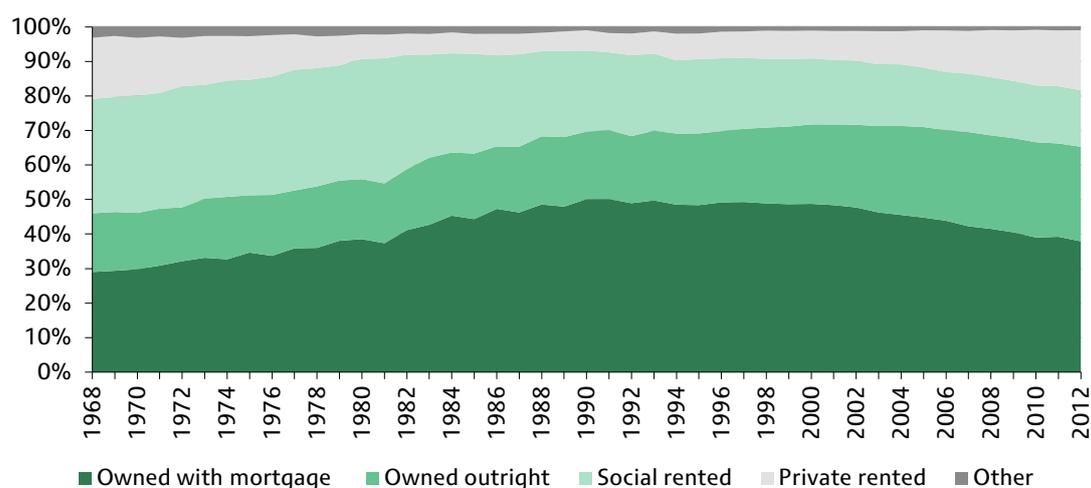
There has been a well-documented recent shift in the balance between owner-occupation and the private rental sector, starting to reverse the rise in owner-occupation that we saw for much of the latter half of the 20th century. Figure 3.3 shows that the percentage of the population in owner-occupied accommodation began to fall in the early 2000s, and the fall has since accelerated, with a decline of more than 4 percentage points (ppts) in the five years between 2007–08 and 2012–13. Correspondingly, we have seen rapid growth in the private rented sector, with an increase of 5ppts between 2007–08 and 2012–13. The steady decline in homeownership, combined with reductions in real incomes and reduced availability of high loan-to-value (LTV) mortgages since the financial crisis, is the background to the coalition’s flagship Help to Buy initiative (see Box 3.1) – the latest in a line of policies designed to support homeownership.

As shown in Figure 3.4, this important trend largely reflects a difference between generations – those born later have been significantly less likely to move into owner-occupation than their predecessors at the same stage in life.²⁸ The graph shows the evolution of homeownership rates with age for people born in different years. Starting with those born in the mid-1970s (now aged in their late 30s), successive birth cohorts have clearly had lower homeownership rates than the last. The age-25 homeownership rate has halved in 20 years: 45% of those born in the mid-1960s owned a home at this age, compared with 33% for the mid-1970s cohort and only 20% for the mid-1980s cohort. The evidence so far suggests that these may well turn out to be permanent differences between generations, rather than simply changes in the timing of house purchase due to factors such as changes in the timing of family formation. For example, by age 35, the homeownership rate of individuals born in the mid-1970s remained 10 percentage points lower than for the cohort born a decade earlier at the same age.

²⁷ B. Tunstall, ‘Relative housing space inequality in England and Wales, and its recent rapid resurgence’, *International Journal of Housing Policy*, published online January 2015.

²⁸ Here we count as homeowners only the household head and their partner, rather than all household members, in a house that is owner-occupied. For example, an adult living with homeowning parents would not be counted as a homeowner in Figure 3.4, but they would be counted as living in owner-occupied housing in Figure 3.3.

Figure 3.3. Percentage of the population in each tenure type (GB)



Note: Social rented is defined as rented from a local authority or a housing association.

Source: Authors' calculations using the Family Resources Survey and Family Expenditure Survey, various years.

Box 3.1. Help to Buy

Successive governments have sought to promote homeownership, through policies that help people to purchase a home (such as Right to Buy) and policies that make owner-occupation more attractive relative to renting (for example, via preferential tax treatment). Although house prices relative to earnings fell between 2007–08 and 2012–13, the financial crisis reduced the availability of high loan-to-value (LTV) mortgages, meaning those wanting to purchase a home had to find larger deposits in order to do so.

In the March 2013 Budget, the government announced 'Help to Buy' – a major package of reforms to help people purchase a home. There are two distinct components of Help to Buy. The first is an 'equity loan' scheme whereby government provides loans worth up to 20% of the purchase price of newly-built homes. These loans are interest-free for the first five years, and give the government an 'equity' stake in the property, in the sense that loans are repaid as a percentage of the property's current market value. The second element of Help to Buy is a 'mortgage guarantee' scheme, which aims to increase the availability of high LTV mortgages by offering mortgage lenders the option of purchasing government-backed insurance on such loans. Both schemes are set to run from 2013 to 2016 and are available on purchases up to £600,000.

The government's rationale for Help to Buy appeals to both equity and efficiency. Both schemes will make it easier for people with small deposits to purchase a home, addressing concerns that large deposit requirements might restrict homeownership to people whose parents can provide financial help. In addition, these schemes address supposed 'market failures' in the construction and mortgage markets. A key goal of the equity loan scheme is to increase construction by raising demand for new homes relative to old ones – justified on the basis of widespread concerns that the construction industry in the UK is insufficiently responsive to price signals. The mortgage guarantee scheme has been justified on grounds that the financial crisis led banks to an overcautious assessment of risk, causing a massive contraction in the availability of high LTV mortgages, which were popular with first-time buyers before the crisis. However, in practice, it is actually quite difficult to say how far either of these represents genuine market failures.^a

Data are now available for the first 18 months of the equity loan scheme (April 2013 to September 2014) and the first 12 months of the mortgage guarantee scheme (October 2013 to September 2014).^b Around four-fifths of loans under both schemes have been made to first-time buyers (who have made up about two-fifths of all purchases in recent years^c). The median household income of borrowers taking up the mortgage guarantee scheme was £42,683, which is very close to the median household income of £43,097 for all those buying a house with a mortgage over the same period.^d The mean value of properties purchased through the mortgage guarantee scheme was £156,000, and for the equity loan scheme it was £210,000 – compared with the average sale price of £251,000 across the UK in 2013.^e These lower average values reflect in part the fact that most completions under both schemes have been outside London and the South East, in regions where prices are lower.

A key goal for the equity loan scheme was to increase the supply of new homes, over and above what would have happened in the absence of the scheme, by stimulating demand for new homes relative to existing ones. To our knowledge, there has been no serious assessment of whether the scheme has generated genuinely additional demand for new housing and/or whether the supply of new housing has responded to any increase in demand (and the National Audit Office has suggested that the government is not collecting sufficient information to carry out such an assessment in any case^f). Turning to the mortgage guarantee scheme, the Bank of England suggests that the scheme has led to a return to high LTV lending, though these loans still represent a much smaller proportion of the market (less than 10% in 2014 up to October) than they did in 2007 (25%).^g

The mortgage guarantee scheme was initially widely criticised on grounds that it would stimulate demand for but not supply of housing, thereby driving up prices. Although house prices have increased substantially since the introduction of Help to Buy, the Bank of England has suggested that the mortgage guarantee scheme ‘does not appear to have been a material driver of that growth’, pointing to low take-up in London where price growth has been strongest and to the limited size of the scheme overall (about 5% of total mortgaged house purchases between 2007 and October 2014).^g

^a D. Chandler and R. Disney, ‘Housing market trends and recent policies’, in C. Emmerson, P. Johnson and H. Miller (eds), *The IFS Green Budget: February 2014*, Institute for Fiscal Studies, London, 2014, <http://www.ifs.org.uk/publications/7072>.

^b DCLG, ‘Help to Buy equity loan scheme and Help to Buy: NewBuy statistics – data to 30 September 2014, England’, 30 October 2014, <https://www.gov.uk/government/statistics/help-to-buy-equity-loan-scheme-and-help-to-buy-newbuy-statistics-april-2013-to-september-2014>; HM Treasury, ‘Help to Buy mortgage guarantee scheme quarterly statistics’, 28 November 2014, <https://www.gov.uk/government/statistics/help-to-buy-mortgage-guarantee-scheme-quarterly-statistics-october-2013-to-september-2014>.

^c DCLG, ‘Table FA2221 (S321): type of purchase by household type’, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/333090/FA2221_type_of_purchase_by_household_type.xls.

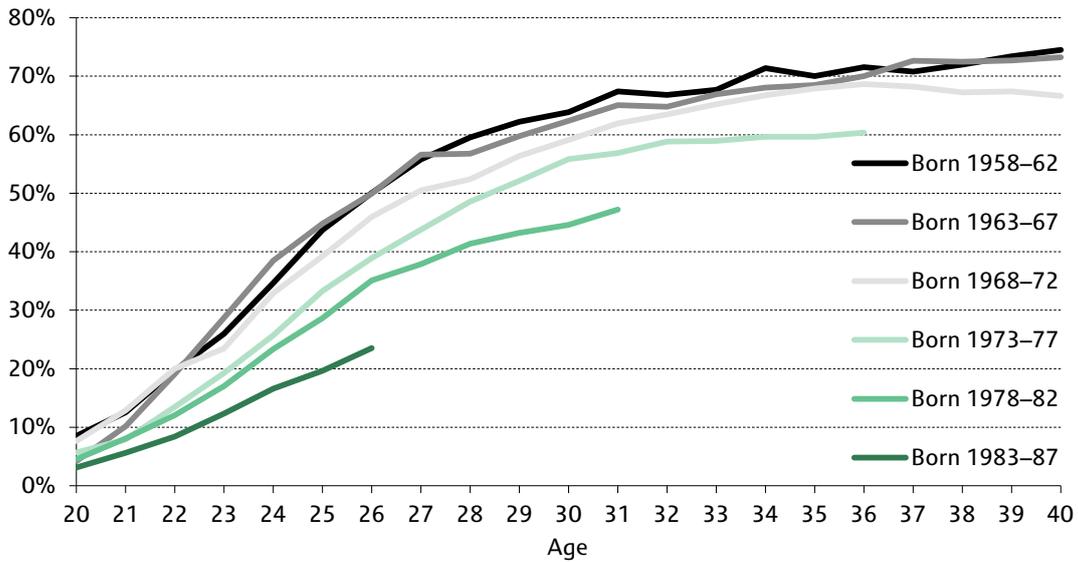
^d Page 6 of HM Treasury, ‘Help to Buy mortgage guarantee scheme quarterly statistics’, 28 November 2014, <https://www.gov.uk/government/statistics/help-to-buy-mortgage-guarantee-scheme-quarterly-statistics-october-2013-to-september-2014>.

^e ONS, ‘House price index (HPI), October 2014: reference tables – annual tables 20 to 39’, 16 December 2014, <http://www.ons.gov.uk/ons/rel/hpi/house-price-index/october-2014/index.html>. This is a simple average of sale prices over the period, and therefore differs from the Nationwide ‘mix-adjusted’ index used elsewhere in this briefing note.

^f National Audit Office, *The Help to Buy Equity Loan Scheme*, London, 2014, <http://www.nao.org.uk/wp-content/uploads/2015/03/The-Help-to-Buy-equity-loan-scheme.pdf>.

^g M. Carney, ‘Assessment of help to buy: mortgage guarantee’, letter to the Chancellor, 2 October 2014, <http://www.bankofengland.co.uk/financialstability/Documents/fpc/letters/governorletter141002.pdf>.

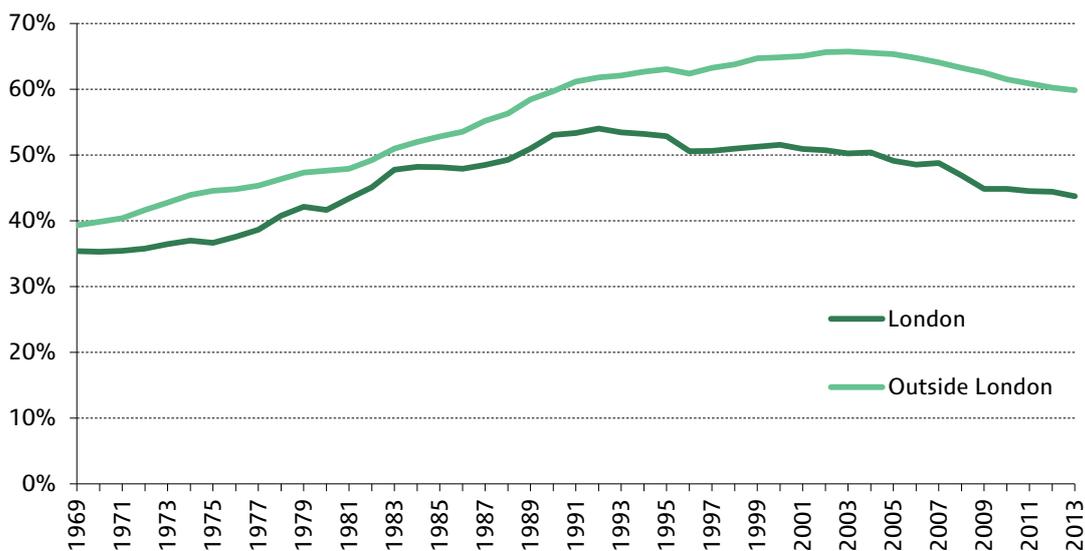
Figure 3.4. Homeownership rates, by birth year and age (GB)



Source: Authors' calculations using Family Expenditure Survey, Family Resources Survey and Labour Force Survey, various years.

Figure 3.5 shows that the decline in homeownership has been particularly rapid in London. Between 1969 and 1992, London had a homeownership rate between 3 and 8ppts lower than the rest of Great Britain. However, homeownership rates in London peaked in 1992 – about a decade before the peak in the rest of Great Britain – and have been declining for most of the period since. By 2013–14, the homeownership rate was 16ppts lower in London than in the rest of the country. Outside of London, the homeownership rate is back to its 1990 level. In London, the home-ownership rate is at its lowest level since 1981. All of this is, perhaps, unsurprising, given the particularly large increases in London house prices in absolute terms, relative to earnings and relative to young adults' earnings in particular (see Section 2).

Figure 3.5. Homeownership rates inside and outside London, by region (GB)



Note: Up until 1992, figures are three-year moving averages to ensure sufficient sample sizes.

Source: Authors' calculations using Family Expenditure Survey, Family Resources Survey and Labour Force Survey, various years.

In summary, the data presented in this section look consistent with a situation in which constrained housing supply, particularly in London, has contributed to rising prices with broadly the expected distributional consequences. Those who already owned homes when these trends began – mostly in older generations – are less affected: indeed, living space for owner-occupiers and for older age groups has been rising. Meanwhile, those not already homeowners then – mostly younger generations – are more likely to still be renting, and to be renting with less space, as a result.

4. Future challenges

House prices have increased substantially over the past 20 years, both in real terms and relative to incomes. This appears to be having large distributional consequences. Younger generations are much more likely to still be renting than their predecessors were at the same age – and to be renting with less space. This trend is particularly pronounced in London, where house prices have risen particularly quickly in real terms and relative to young adults' earnings. Older generations, on the other hand, were able to buy property when its price was much lower. The primary impact of house price rises on them has therefore been to increase their housing wealth. Floor space per person for owner-occupiers and for older age groups has been rising.

These trends raise several challenges for policy in the years ahead.

We have outlined some reasons to worry that a mismatch between supply and demand is behind some of the rises in house prices, particularly in London. Policies that look to address this are therefore likely to be important, both for living standards overall and for inequalities (between generations and between regions, for example). As ever, prices can be depressed either through policies that reduce demand or, perhaps more likely, policies that increase supply. Given this, the regime of planning regulations would seem the most natural thing to look at first.

A clear way of improving the efficiency of the way that we tax housing could also, as it happens, be of particular assistance to credit-constrained first-time buyers. Stamp duty land tax (SDLT), which is payable upon the purchase of a house, is an extremely damaging tax. One of the most basic tenets of the economics of taxation is that transactions taxes should be avoided. The effect of SDLT is to discourage mutually beneficial transactions, so that properties are not held by the people who value them most. The tax should be abolished. If the government wanted to make up the revenue from elsewhere in the system of housing taxation, it could do so through a revalued and reformed council tax system. This would reduce the amount of liquid cash needed at the time of house purchase (without necessarily involving a net tax cut for homeowners) and would mean that the housing stock is allocated more efficiently in the process – with homes owned by those who value them most. At the very least, a future government should resist the urge to raise SDLT, which the current and previous governments have repeatedly succumbed to.

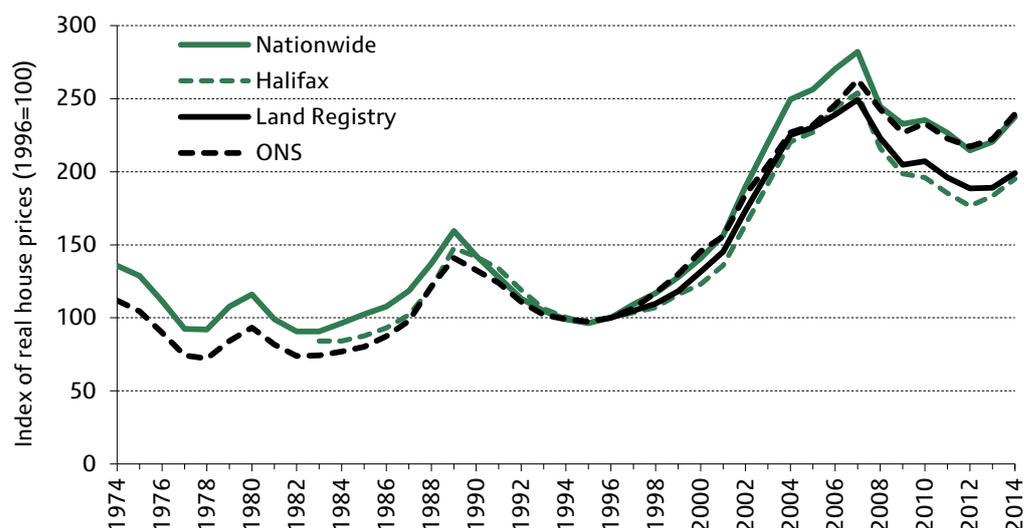
Ultimately, the housing stock currently held by older generations will come to be owned by younger generations, much of it probably via inheritance or financial assistance from parents to children in purchasing a house. The likely rise in the role of inheritance and other intergenerational transfers in determining people's resources, and their access to homeownership, would increase the importance of the design of certain parts of the tax system. As discussed in detail by the Mirrlees Review, inheritance tax currently has a number of loopholes and avoidance opportunities and is in need of reform, abolition or replacement with something else. If a government wanted to use the tax system to pursue equality of opportunity – which is the main potential justification for taxing inheritances – there would be a case for abolishing inheritance tax entirely and replacing it with a tax on the lifetime receipt of

inheritances and gifts. That in itself would involve practical and administrative challenges, though.²⁹

Finally, given the fiscal situation, any future government is likely to consider further cuts to social security (the Conservatives have explicitly indicated that they would like to find a further £12 billion per year of social security cuts). Housing benefit will account for a forecast 12% of social security spending in 2015–16,³⁰ with spending in real terms having almost doubled over the past two decades and still rising overall during this parliament despite discretionary cuts to its generosity.³¹ Continued real rises in rents would continue to exert upwards pressure on the housing benefit bill, as might the ongoing decline of owner-occupation and corresponding increase in the size of the private rented sector. One important decision for a future government is whether it is willing to earmark increasing amounts of its budget to cover all of these costs, or whether to rethink the design of housing benefit further in ways that contain rises in exchequer cost – with the important trade-off, of course, that this would create low-income losers.

Appendix

Figure A.1. Growth in real average house prices according to the major house price indices (1996=100)



Note: Years refer to calendar years up to 1992 and financial years from 1993 (where ‘1993’ refers to the financial year 1993–94), except 2014 for which data are only available up to 2014Q4. House prices are calculated by averaging over the relevant periods of the various house price indices. Nominal house prices are deflated using the CPI excluding rents from 1996–97 onwards. Before 1996–97, this inflation measure is not available, so we use Rossi inflation minus 0.36 percentage points, which was the average difference between Rossi and the CPI minus rents between 1996–97 and 2008–09.

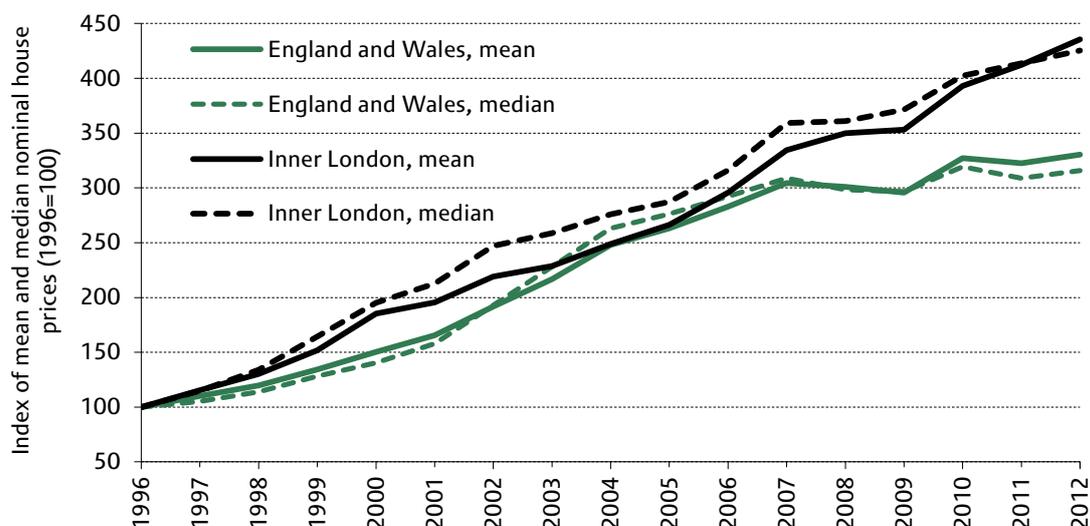
Source: Nationwide, Halifax, ONS and Land Registry house price indices; price index – authors’ calculations using ONS series D7G7, D7GQ, CJVC and GUMG.

²⁹ See R. Boadway, E. Chamberlain and C. Emmerson, ‘Taxation of wealth and wealth transfers’, in J. Mirrlees, S. Adam, T. Besley, R. Blundell, S. Bond, R. Chote, M. Gammie, P. Johnson, G. Myles and J. Poterba (eds), *Dimensions of Tax Design*, Oxford University Press for the Institute for Fiscal Studies, Oxford, 2010, <http://www.ifs.org.uk/publications/7184> and chapter 16 of J. Mirrlees, S. Adam, T. Besley, R. Blundell, S. Bond, R. Chote, M. Gammie, P. Johnson, G. Myles and J. Poterba, *Tax by Design*, Oxford University Press for the Institute for Fiscal Studies, Oxford, 2011, <http://www.ifs.org.uk/publications/5353>.

³⁰ A. Hood and D. Phillips, ‘Benefit spending and reforms: the coalition government’s record’, IFS Briefing Note BN160, 2015, <http://www.ifs.org.uk/publications/7535>.

³¹ A. Hood and L. Oakley, ‘The social security system: long-term trends and recent changes’, IFS Briefing Note BN156, 2014, <http://www.ifs.org.uk/publications/7438>.

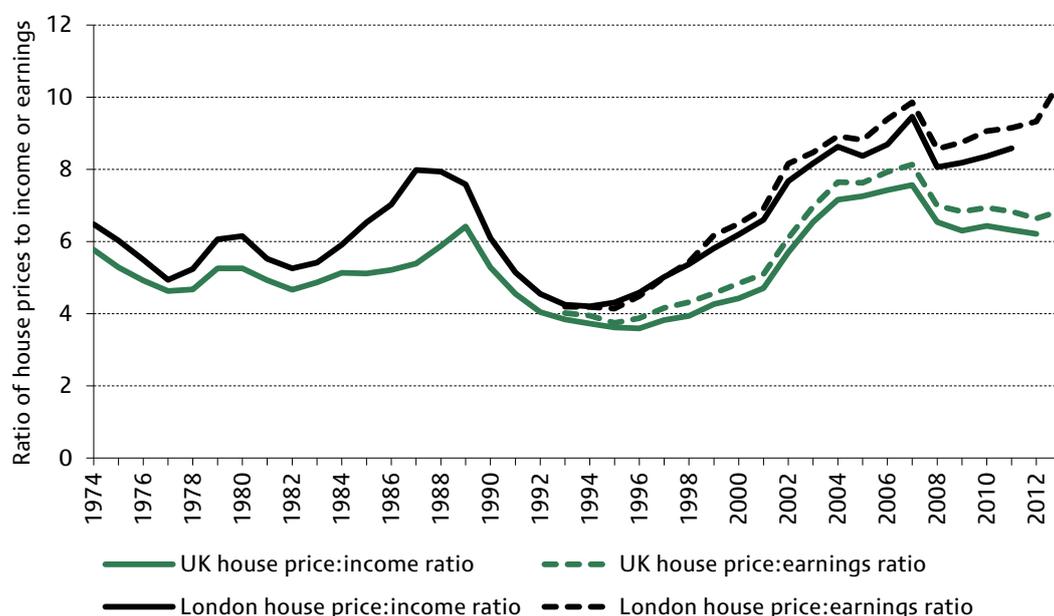
Figure A.2. Mean and median nominal house prices for England and Wales and London since 1996 (based on Land Registry data)



Note: In this figure, mean and median house prices refer to the mean and median nominal price of property transactions recorded by the Land Registry in each year. This is different from the measure of house prices provided by the Land Registry's house price index (in Figure A.1), which controls for changes in quality using a repeat sales method (for a discussion, see D. Chandler and R. Disney, 'Measuring house prices: a comparison of different indices', IFS Briefing Note BN146, 2014, <http://www.ifs.org.uk/bns/bn146.pdf>).

Source: DCLG live tables 585 and 586, based on Land Registry data.

Figure A.3. House price to income and earnings ratios for the UK and London



Note: Years refer to calendar years up to 1992 and financial years from 1993 (where '1993' refers to the financial year 1993–94), except 2014 for which data are only available up to 2014Q4. House prices are calculated by averaging over the relevant periods of the various house price indices. Incomes for London are a three-year moving average to ensure a reasonable sample size.

Source: Nationwide, Labour Force Survey, Family Expenditure Survey and Family Resources Survey (various years).